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Supreme Court of the United States

OCTOBER TERM, 1946

No. 42
No. 43

IN THE MATTER
of
AMERICAN FUEL & POWER COMPANY, INLAND GAS CORPORATION,
KENTUCKY FUEL GAS CORPORATION,
Debtors.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE,
Petitioner
against
LOUIS A. GREEN and ROBERT HEILBRUNN, Known in these Proceedings as the GREEN COMMITTEE and MORRIS GREEN,
Respondents.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE,
Petitioner,
against
CARL B. EARLY, DANIEL MATTHEWS, THOMAS MATTHEWS, JACK PATTON and P. G. MEADOR,
Respondents.

BRIEF FOR PETITIONER

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BRIEF FOR PETITIONER

Opinions of Courts Below

The District Court rendered no opinion but during argument stated the grounds for its decision (R. 56), and

thereafter made an order and judgment embodying findings of fact and conclusions of law (R. 192).

The opinion of the Circuit Court of Appeals, Sixth Circuit, is reported 151 F. (2d) 470 (1945), and is also reprinted at R. 214 *et seq.*

Jurisdiction

The judgments of the Circuit Court of Appeals which Petitioner seeks to have reviewed were filed on October 9, 1945 (R. 213, 214). A timely petition for re-hearing was made to the Circuit Court of Appeals (R. 234, 235) and was denied November 26, 1945 (R. 241). The petition for writs of certiorari made on behalf of Vanston Bondholders Protective Committee was filed herein on February 14, 1946. The order of this Court granting the writs of certiorari was filed March 25, 1946 (R. 242).

Jurisdiction to review this case upon writs of certiorari is expressly conferred upon this Court by Judicial Code, Section 240, as amended (Act of March 3, 1891, c. 517, Sec. 6, 26 Stat. 828; Act of March 3, 1911, c. 231, Sec. 240, 36 Stat. 1157; Act of February 13, 1925, c. 229, Sec. 1, 43 Stat. 938; 28 U. S. C., Sec. 347), and by Bankruptcy Act, Sec. 24 (c), as amended (Act of June 22, 1938, c. 575, Sec. 1, 52 Stat. 854; 11 U. S. C., Sec. 47).

Statement of Case

The Circuit Court of Appeals, in a proceeding under Chapter X of the Bankruptcy Act, invalidated an express agreement that overdue bond coupons should bear simple interest from their respective due dates.

Inland Gas Corporation, hereafter called the "Debtor", issued to the investing public First Mortgage Bonds which were secured by an Indenture of Mortgage dated February 1, 1928 (R. 197-205). By the express terms of the Indenture, appropriately referred to in the Bonds, the bondholders are entitled to "*interest on* overdue principal and *overdue installments of interest* at the same rates respec-

tively as were borne by the respective bonds" (R. 199, 204).* The validity of this contractual provision (R. 192-197) is the question before the Court.

The transaction involved herein has substantial contacts with several states. The Indenture was executed in the State of *New York* by the Debtor, a Delaware corporation, to Chatham-Phenix National Bank and Trust Company and James F. McNamara, Trustees. By the terms of the Bonds they and the coupons were both payable, at the option of the bearer, either at the office of the corporate trustee in the City of New York or at the office of Continental National Bank & Trust Company in the City of Chicago, State of *Illinois* (R. 197-8, 202). The business and principal assets of the Debtor, including the mortgaged property, are located in *Kentucky* (R. 121, 153, 230). The Debtor's parent, American Fuel & Power Corporation, which is a multi-state holding company (R. 23, 122-3),** was incorporated in Delaware (R. 5). It became a Debtor in 77-B proceedings in that State, but these proceedings, which later became Chapter X proceedings, were transferred to the District Court in Kentucky (R. 5).

It is undisputed that under the law both of Illinois and of Kentucky the Indenture provision concerning simple interest on overdue coupons is valid. The Circuit Court of Appeals has so held (see Opinion in the instant case, footnote 1, R. 220; 151 F. (2d) at 475). Whether the provision is valid under the law of New York, is disputed (see *infra*, Point II).

The District Court held the promise to be valid, and directed that interest be paid on the coupons (R. 56). The Circuit Court of Appeals reversed "with respect to the allowance of interest upon the interest coupons", holding the contractual provision for such interest on the coupons

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* Throughout this brief emphasis is supplied, unless otherwise indicated.

** See Opinion in this case, 151 F. (2d) at 472-3; see also *Columbia Gas and Electric Corp.* vs. *United States*, 151 F. (2d) 461, 463 (C. C. A. 6th, 1945); Moody's Public Utilities, 1944, pp. 1192-4.

to be invalid (R. 213). It is this ruling which Petitioner seeks to have reviewed.

The Circuit Court of Appeals recognized that it was faced with a problem of choice of law and that it could reach the question of the validity of the interest provision only after having ascertained "from what source we should seek controlling jurisprudence" (R. 219; 151 F. (2d) at 475). The Court further recognized that before it could approach this choice of law problem, it had to determine the preliminary question whether a federal choice of law rule should govern in bankruptcy proceedings or whether, as in diversity cases, the rule should be borrowed from the law of the State of the forum. The opinion of the Circuit Court of Appeals states that this Court has "expressly pretermitted the question" of whether the doctrine of *Erie* vs. *Tompkins*, 304 U. S. 64 (1938), applies in a bankruptcy case like the present one (R. 220; 151 F. (2d) at 475).

The Circuit Court of Appeals nevertheless followed *Erie* vs. *Tompkins, supra,* and applied the choice of law rule of the forum State, Kentucky. Under that rule, as understood by the Circuit Court of Appeals, New York law governed the validity of the transaction. The Circuit Court of Appeals further held that New York law, while difficult to determine, invalidated the Indenture provision concerning simple interest upon overdue coupons. Every step in this reasoning of the Circuit Court of Appeals was brought up for review by the petition for writs of certiorari.

The issue arises in a proceeding under the Bankruptcy Act. From 1930 to 1935 the Debtor was in federal equity receivership (R. 154). Since 1935 it has been in a reorganization proceeding in the United States District Court for the Eastern District of Kentucky, first under Section 77-B and later under Chapter X of the Bankruptcy Act, and during this period the property of the Debtor has been in the hands of a Trustee appointed in such proceedings (R. 156 *et seq.*). The last coupon paid was that due August 1, 1930 (R. 154, 70).

It is not disputed that the assets in the hands of the bankruptcy trustee, which are subject to the first lien of the First Mortgage Bonds, are sufficient to satisfy all claims of the holders of these Bonds (R. 56). Through operation of the mortgaged properties the trustee accumulated a substantial amount in cash and government securities (193), and in November, 1943 an application was made to the bankruptcy court on behalf of holders of the First Mortgage Bonds for distribution of part of these liquid assets (R. 166). The Vanston Committee, the Petitioner herein, also representing holders of First Mortgage Bonds (152, 154), joined in that application (R. 215; 151 F. (2d) at 473). In his response to the application the Trustee presented for determination by the bankruptcy court the issue, among others, of the validity of the Debtor's promise to pay simple interest on the interest coupons held by the First Mortgage Bondholders (R. 172). This issue is being litigated by the Vanston Committee and the Van Horn Committee representing First Mortgage Bondholders, against the Green Committee and the Early Committee representing the holders of junior securities. The Vanston Committee is Petitioner in No. 42 and No. 43; the Van Horn Committee is Petitioner in the companion cases No. 44 and No. 45.

Specification of Errors to be Urged

1. The Circuit Court of Appeals erred in holding that the rule determining the choice of the governing law regarding the validity of an interest provision in a multi-state contract made by a Debtor in Chapter X Bankruptcy Proceeding should be borrowed from the law of the forum State and should not be a federal rule.

2. The Circuit Court of Appeals erred in invalidating such provision, since

(a) the provision does not violate the public policy of any of the States involved, or of the United States, and

(b) the provision would have been upheld if there had been litigation concerning its validity in the courts of any of the States involved.

Summary of Argument

1. Since *Erie* vs. *Tompkins, supra,* and its derivatives are not applicable in proceedings under the Bankruptcy Act, a federal rule should govern problems of choice of law arising in such proceedings. In the present case the federal choice of law rule would point to the law of Illinois or Kentucky, and under the law of both these States the Indenture provision concerning interest on overdue coupons is concededly valid.

2. The Indenture provision struck down by the Circuit Court of Appeals does not violate the public policy of the United States or of any of the three States involved.

(a) The Kentucky choice of law rule, if properly ascertained, does not point to New York law.

(b) Even if New York law were held to govern the validity of the interest provision in the Indenture, that provision would be valid.

The Circuit Court of Appeals, sitting as a bankruptcy court, should not have invalidated a multi-state contractual promise which would have been upheld in state court litigation in each of the States with which the transaction has any substantial and normal contact.

POINT I.

In determining the rule for the choice of the governing law concerning the validity of an interest provision in a multi-state contract made by a debtor in Chapter X Bankruptcy Proceedings, a federal bankruptcy court should not borrow such rule from the forum State but should select the federal choice of law rule which points to the law of those jurisdictions where the transaction would be upheld.

Disregarding the State of incorporation of the Debtor and its parent, and looking only (a) to the place of contracting, (b) the two alternative places of performance, and (c) the location of the Debtor's business and of the mortgaged property, we find that the transaction giving rise to the promise in issue had substantial contacts with at least three States: New York, Illinois and Kentucky. Hence, assuming that the Circuit Court of Appeals was correct in considering the issue one of "local law", the question is *which* of these three States should furnish the applicable rule of "local law". There is thus presented a question of *choice of law.*

A. Inapplicability of Erie *v.* Tompkins.

Before the Court can ascertain the correct choice of law rule, it is faced with the preliminary question: Which body of law is the proper *source* for the applicable rule determining such choice? More concretely, before the Bankruptcy Court can choose between the local law of Kentucky, New York and Illinois, it has to decide whether the choice of law rule should be a federal rule or a local rule.

The Circuit Court of Appeals (151 F. (2d) at 475) clearly recognized this issue:

> "The opinion in Klaxon Co. *v.* Stentor Co., 313 U. S. 487, 496, 497, 61 S. Ct. 1020, 85 L. Ed. 1477, announced that, under the doctrine of Erie R. Co. *v.* Tompkins,

304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A. L. R. 1487, the federal courts, when deciding questions of conflict of laws, in diversity of citizenship cases, must follow the rules prevailing in the states in which they sit.

"But, in D'Oench, Duhme & Co. *v.* F. D. I. C., 315 U. S. 447, 456, 62 S. Ct. 676, 86 L. Ed. 956, the Supreme Court expressly pretermitted the question of whether the rule of the Klaxon case applies where federal jurisdiction is not based on diversity of citizenship. The instant case rests on no such jurisdiction, but upon the jurisdiction of the federal district court sitting in bankruptcy, in a reorganization proceeding, in the State of Kentucky."

The Supreme Court again "pretermitted" the problem, and perhaps pointed the way towards its solution, in *McKenzie, Trustee in Bankruptcy* vs. *Irving Trust Company*, 323 U. S. 365, 371, Footnote 2 (1945). The lower federal courts are divided. The Circuit Court of Appeals for the Sixth Circuit adheres to the view that a Federal District Court sitting as a bankruptcy court should apply the choice of law rule of the State wherein it sits. See the case at bar, and also *United Construction Company* vs. *Milan*, 124 F. (2d) 670 (C. C. A. 6th, 1942). The Circuit Court of Appeals for the 8th Circuit has wavered between applying a local choice of law rule in *Robbins* vs. *Bostian*, 138 F. (2d) 622, 625 (C. C. A. 8th, 1943) and applying a federal rule in *Winkle* vs. *Scott*, 99 F. (2d) 299, 301 (C. C. A. 8th, 1938), cert. den.,* 306 U. S. 634 (1939), a case involving the defense of usury in a multi-state transaction. The Circuit Courts of Appeals for the 7th and 9th Circuits and a number of District Courts turned to federal law when they had to solve a choice of law problem in bankruptcy proceedings. See *In Re Chicago, Rock Island & Pacific Railway Company* (*Traphagen* vs. *Fleming*), 155 F. (2d) 889, 893 (C. C. A. 7th, 1946); *Hamaker* vs. *Heffron*,

* The petition for certiorari in that case did not raise the choice of law point.

148 F. (2d) 981, 983, Footnote 3 (C. C. A. 9th, 1945); *In Re Champion Shoe Machinery Company*, 17 F. Supp. 985, 986 (D. C. E. D., Mo., 1937); *In re Central of Georgia Railway Company*, 58 F. Supp. 807, 811 (D. C. S. D., Ga., 1945) reversed on other grounds sub. nom. *Liberty National Bank & Trust Company* vs. *Bankers Trust Company*, 150 F. (2d) 453 (C. C. A. 5th, 1945).

The holding of the Circuit Court of Appeals in the instant case, that the law of the State of the forum furnishes the choice of law rule applicable in bankruptcy, is based on the premise that the rule of *Erie* vs. *Tompkins*, *supra*, and *Klaxon Co.* vs. *Stentor Co.*, *supra*, is applicable in non-diversity cases. This premise is not borne out by the decisions of this Court. The opinion in *Klaxon Co.* vs. *Stentor Co.*, 313 U. S. at 494, 497 contains express limiting language to the effect that "in diversity cases" the federal courts follow the choice of law rule of the forum.

Both *Erie* vs. *Tompkins*, *supra*, and *Klaxon* vs. *Stentor*, *supra*, are based on a statute, the Rules of Decision Act (28 U. S. C. Sec. 725) under the terms of which it has been held that "for purposes of diversity suits a federal court is in effect only another court of the state". See *Holmberg* vs. *Armbrecht*, 66 S. Ct. 582, 583-4 (1946). In bankruptcy the rule is different. Although the Bankruptcy Act uses the existing organization of the Federal District Courts, it is nevertheless fundamental that courts of bankruptcy as such are separate and distinct courts and that they "exercise the powers and jurisdiction in bankruptcy proceedings quite separate and distinct from the powers and jurisdiction inhering as district courts". 3 Hughes, Federal Practice, Section 1425, quoted with approval in *Hanna* vs. *Brictson Manufacturing Company*, 62 F. (2d) 139, 145 (C. C. A. 8th, 1932). We consider a Federal District Court sitting in bankruptcy to be as distinct a tribunal as though it were a separate statutory court dealing only with bankruptcy matters. It is not trammeled by the necessity of relying on diversity jurisdiction.

Bankruptcy jurisdiction and diversity jurisdiction are derived from different constitutional sources (*Duggan* vs. *Sansberry*, 66 S. Ct. 657, 662 (1946)), and serve different ends. It is therefore only natural that the general rule concerning the application of local law which was laid down by this Court for the guidance of bankruptcy courts, is entirely different from the rule prevailing in diversity cases. Nothing decided in *Erie* vs. *Tompkins* "requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are provable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants". *Heiser* vs. *Woodruff*, 66 S. Ct. 853, 855-6 (1946).* See also *American Surety Company* vs. *Sampsell*, 66 S. Ct. 571, 573 (1946), where this Court said:

> "True, we stated in both *Prudence* opinions that the federal law governing distribution of a bankrupt's estate should be applied with appropriate regard for rights acquired under rules of state law. But the extent to which state law is to be considered is in the last analysis a matter of federal law."

B. THE PROPER SOURCE FOR CHOICE OF LAW RULES IN BANKRUPTCY PROCEEDINGS.

The specific question, whence comes the choice of law rule for a Bankruptcy Court, must be answered in accordance with the express or implied command of the applicable provisions of the Bankruptcy Act (§§ 63, 67, 70, 200; 11 U. S. C., §§ 103, 107, 110, 600). The Constitution authorizes Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States" (Art. I, Sec. 8,

*Following the quoted language, Chief Justice STONE cited a number of recent cases, including *Sola Electric Co.* vs. *Jefferson Electric Co.*, 317 U. S. 173, 176 (1942) and *Wragg* vs. *Federal Land Bank*, 317 U. S. 325, 328 (1943), all of which demonstrate the inapplicability of *Erie* vs. *Tompkins* and its derivatives in non-diversity cases. A similar, and perhaps even more pointed statement than that in the *Heiser* case is to be found in *In Re Pittsburgh Rys. Co.*, 155 F. (2d) 477, 483, footnote 13 (C. C. A. 3rd, 1946).

cl. 4). This has been held to require geographical uniformity, but not to preclude reference to the law of a State with which the transaction in question has a substantial and natural contact. Thus, as to exemptions, this Court upheld a provision referring to the local rule of the State of the debtor's domicile. *Hanover National Bank* vs. *Moyses*, 186 U. S. 181 (1902). Questions of title or dower may be governed by the law of the State where the property is located. See cases collected in 1 *Remington on Bankruptcy*, 4th Ed., Sections 2 to 6. But no case has been found where the rights of parties under the Bankruptcy Act were made to depend upon the law of a State, not because of any substantial and natural contact with the transaction, but merely because it happened to be the State of the forum.

The Bankruptcy Act does not, and constitutionally cannot, refer in any respect to the substantive law of the forum. In Chapter X proceedings the forum is largely a matter of accident. It may be where the corporation has its principal place of business, or its principal assets, or, if the corporation be a subsidiary, either of these two places as applied to its parent, which may give a third or fourth choice of forum. Bankruptcy Act, §§ 128, 129; 11 U. S. C., §§ 528, 529. In the present case the forum could have been Delaware, which is the State of incorporation of the Debtor (R. 152-3), and also the State in which a 77 B proceeding against the parent, American Fuel and Power, was initially brought; the latter proceeding was later moved from the United States District Court in Delaware to the United States District Court in Kentucky (R. 5, 10).

It follows that had the instant case been moved to or initiated in Delaware, or perhaps some other jurisdiction in which the parent might have had its principal assets, then, under the rule adopted by the Circuit Court of Appeals, a different decision could have followed. If the parent had guaranteed the coupons in question, and the bankruptcy proceeding against it had remained in the Delaware Court, one rule as to interest on interest might have been applied against the parent-guarantor and another rule against the principal debtor.

In the area of bankruptcy, in which the Constitution itself imposes a rule of *uniformity*, there is no reason to follow the *conformity* rule of the diversity cases. Uniformity, that is independence of the law of the forum, can be accomplished only by a federal choice of law rule.

C. THE FEDERAL CHOICE OF LAW RULE APPLICABLE TO THE INSTANT CASE.

The parties to the contract before the Court expressly stipulated for simple interest on overdue coupons. They obviously intended this contractual provision to be valid. The federal choice of law rule upholds this intention of the parties. That rule points to the law of Illinois and Kentucky, that is, of those states which concededly uphold the promise. It has been established by a long line of cases in this Court and in the lower federal courts that where a contract is made in one state and is to be performed in another, or where otherwise the contract has genuine contacts with several states, the parties are presumed to have contracted with reference to the law of that state which would uphold the contractual provisions regarding interest: *Seeman* vs. *Philadelphia Warehouse Company*, 274 U. S. 403 (1927) and cases cited; *Cromwell* vs. *County of Sac*, 96 U. S. 51, 60-62 (1877).

Respondents argue that the *Seeman* case, which was decided prior to *Erie* vs. *Tompkins*, should no longer be followed. As authority for this argument respondents rely on a footnote in Mr. Justice JACKSON's opinion in *Corn Exchange Bank* vs. *Klauder*, 318 U. S. 434, 437 (1943); but such reliance is misplaced. The footnote in the *Klauder* case merely states that in deciding a question which is controlled by local law, older federal decisions are no longer to be followed. In the case at bar, however, we deal with an area not affected by *Erie* vs. *Tompkins*, and hence not controlled by local law. In such an area there is no reason whatever for discarding a body of federal precedents clearly in point. See *Clearfield Trust Co.* vs. *United States*, 318 U. S. 363, 367 (1943); *Board of County Commissioners* vs. *United States*, 308 U. S. 343, 349-350

(1939). Indeed, the same member of the Court who wrote the opinion in the *Klauder* case emphasized this important distinction in his concurring opinion in *D'Oench, Duhme & Co., Inc.*, vs. *Federal Deposit Insurance Corporation*, 315 U. S. 447 (1942), where he said at page 469:

> "The federal courts have no *general* common law, as in a sense they have no general or comprehensive jurisprudence of any kind, because many subjects of private law which bulk large in the traditional common law are ordinarily within the province of the states and not of the federal government. But this is not to say that wherever we have occasion to decide a federal question which cannot be answered from federal statutes alone we may not resort to all of the source materials of the common law, or that when we have fashioned an answer it does not become a part of the federal non-statutory or common law."

When choice of law problems arise in areas not controlled by *Erie* vs. *Tompkins*, then the applicable choice of law rules are necessarily part of the "federal non-statutory or common law" governing such areas. See *D'Oench, Duhme & Co.* vs. *Federal Deposit Insurance Corporation*, 315 U. S. 447 (1942) at page 472, footnote 10.

Moreover, and apart from its force as a binding precedent, the *Seeman* case still retains its persuasiveness by virtue of the strength of its reasoning which was almost universally accepted by the highest courts throughout the nation.

The *Seeman* case was followed in *Smith* vs. *Western & Southern Life Insurance Co.*, 87 F. (2d) 839, 841 (C. C. A. 5th, 1937); *Brierley* vs. *Commercial Credit Co.*, 43 F. (2d) 724 (D. C., E. D. Pa. 1929), aff'd 43 F. (2d) 730 (C. C. A. 3rd, 1930), cert. den. 282 U. S. 897 (1931); *Armstrong* vs. *Alliance Trust Co.*, 88 F. (2d) 449 (C. C. A. 5th, 1937); *Merchants & Manufacturers Securities Co.* vs. *Johnson*, 69 F. (2d) 940 (C. C. A. 8th, 1934), cert. den. 293 U. S. 569 (1934); *In re Champion Shoe Machinery Co.*, 17 F. Supp. 985, 986 (D. C., E. D. Mo. 1937). The two last-cited cases were receivership and reorganization cases.

Outside of the federal courts the overwhelming weight of judicial and academic authority equally supports the rule that where a contract has substantial contacts (or, as it is sometimes put, a "vital connection") with several states, the validity of an interest stipulation is governed by the law of that state which upholds it. See, for instance, *Coad* vs. *Home Cattle Co.*, 32 Neb. 761, 49 N. W. 757 (1891); *Bigelow* vs. *Burnham*, 83 Iowa 120, 49 N. W. 104 (1891); *United States Savings & Loan Co.* vs. *Shain*, 8 N. Dak. 136, 77 N. W. 1006 (1898); *Midland Savings & Loan Co.* vs. *Henderson*, 47 Okla. 693, 150 Pac. 868 (1915); 2 *Wharton, Conflict of Laws*, 3rd Ed., pages 1190-1, 1209-10; *Goodrich, Handbook of the Conflict of Laws*, 2d Ed. Sec. 108; 2 *Daniel, Negotiable Instruments*, 7th Ed. §§ 1075-6; *Note, Conflict of Laws as to Usury*, 125 A. L. R. 482.* All these authorities make it clear that the place of performance is one of the places having a "vital connection" with the transaction.** The location of the debtor's business, especially if it is in the same state where the property securing the debt is situated, constitutes another "vital connection".† *Green* vs. *Northwestern Trust Co.*, 128 Minn. 30, 150 N. W. 229 (1914); *State* vs. *Rivers*, 206 Minn. 85, 287 N. W. 790 (1939). To the same effect see *Chapman* vs. *Robertson*, 6 Paige 627 (Walworth, Ch., N. Y. 1837); *Arnold* vs. *Potter*, 22 Iowa 194 (1867); *Mott* vs. *Rowland*, 85 Mich. 561, 48 N. W. 638 (1891); *Dugan* vs. *Lewis*, 79 Texas 246, 14 S. W. 1024 (1891); *Armstrong* vs. *Alliance Trust Co., supra.*

It is submitted that under the *Seeman* case and the other authorities cited above, the validity of the contractual provisions concerning simple interest on overdue coupons

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* These authorities are cited merely as examples. Each of these cases, text books and articles in turn refers to numerous other authorities supporting the *Seeman* rule.

** Apart from being one of the places of performance, Chicago had other "vital connections" with the transaction. See *infra*, p. 16, footnote.

† In the *Seeman* case at 408, Mr. Justice STONE substituted for "vital connection" the words "normal relation". It is submitted that the difference is one of phraseology only.

should be judged by the law of Illinois or Kentucky, since the transaction has vital connections with these States, and since under the law of both States the provision can be upheld.

D. Illinois and Kentucky Contacts of the Instant Transaction.

Respondents contend, in spite of the express recognition of the choice of law problem by the Circuit Court of Appeals, that the instant case involves no real question of choice of law.*

They argue that Illinois, since it is merely an alternative place of performance, is not one of the States with which the transaction has a substantial contact. There is a twofold answer to this:

(a) Even if Illinois were eliminated as one of the States having a substantial contact with the transaction, the case would still involve a real choice of law problem. The Debtor's business and principal assets, including the mortgaged property, are located in Kentucky. There is thus no doubt that the latter State is substantially connected with the transaction (see cases cited *supra*, page 14). Respondents' contention that the transaction is referable to only one State, New York, is therefore untenable even if the two alternative places of performance are completely disregarded.

(b) By the terms of the Bonds and the coupons, the Debtor promised to pay at the principal office of the Chatham-Phenix National Bank and Trust Company in New York City, or *at the option of the bearer* at the principal office of the Continental National Bank and Trust Company in Chicago, Illinois (R. 197, 198,

* See p. 6, Response of Early Committee to petitions for writs of certiorari, and p. 5, Response of Green Committee. This contention is curiously inconsistent with respondents' other argument that the case is controlled by *Klaxon* vs. *Stentor*, *supra*, which is unquestionably a choice of law case. See p. 11, Early Committee Response and p. 5, Green Committee Response.

202).* Respondents argue that since New York is thus named ahead of Chicago, New York must be regarded as the sole place of performance for purposes of choice of law, there being no evidence that any bondholder demanded payment at Chicago. The record shows that during the whole period when the coupons involved in this litigation successively fell due, the Debtor was either in federal equity receivership or in proceedings under the Bankruptcy Act (R. 154, 70). The coupons thus remained uncollected and the holder's right to demand payment in Illinois remained unimpaired. That some earlier coupons appear to have been paid prior to any insolvency proceeding, is immaterial. The record does not even show where these earlier coupons were presented. As to the coupons involved herein, the creditors have not yet exercised their option to choose between New York and Chicago as places of payment. Until they do, both places remain substantially connected with the transaction. See *Restatement of the Law of Conflict of Laws*, Section 356.

Moreover, by asserting that of the two places of performance named in the contract, only New York is important for purposes of choice of law, respondents beg one of the principal questions of the case; they simply assume that under the applicable choice of law rule (which rule?) Illinois is not regarded as substantially connected with the transaction. Thus, respondents are merely contending for a particular choice of law rule, while Petitioner (*supra*, pp. 12-14) is contending for another.

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* The Continental National Bank and Trust Co. of Chicago was also designated as an agent for and place of registry of the Bonds (R. 200) and Chicago was designated as a situs for notification by publication of the Debtor's exercise of its right of redemption (R. 199).

POINT II.

The contractual provision for simple interest on overdue interest coupons is valid since it does not violate the public policy of any of the states involved, nor of the United States, and the provision would have been upheld had there been litigation concerning its validity in the courts of any of the states involved.

The decision of the Circuit Court of Appeals strikes down a contractual provision which does not violate the public policy of any of the jurisdictions involved.

No federal public policy prohibits a promise of simple interest on overdue coupons. See *Town of Genoa* vs. *Woodruff*, 92 U. S. 502 (1875); *Amy* vs. *Dubuque*, 98 U. S. 470, 473 (1878); *Edwards* vs. *Bates County*, 163 U. S. 269, 272 (1896). Cf. also *Sexton* vs. *Dreyfus*, 219 U. S. 339, 346 (1911); *Codar* vs. *Arts*, 213 U. S. 223, 245 (1909); *Ticonic Nat. Bank* vs. *Sprague*, 303 U. S. 406, 412-13 (1938).

Nor, concededly, does any public policy of either Kentucky or Illinois stand in the way of such promise. See *McWilliams* vs. *Northwestern Mutual Life Insurance Co.*, 285 Ky. 192, 147 S. W. (2d) 79 (1941); *Radford* vs. *Southern Mutual Life Insurance Co.*, 12 Bush 434 (1876); *Kentucky Title Company* vs. *English*, 20 Ky. L. Rep. 2024, 50 S. W. 968 (1899); *Pensacola & A. R. Co.* vs. *Hilton's Trustee*, 147 Ky. 553, 144 S. W. 1077 (1912); *Bowman* vs. *Neeley*, 137 Ill. 433, 27 N. E. 758 (1891); 151 Ill. 37, 37 N. E. 840 (1894); *Abbott* vs. *Stone*, 172 Ill. 634, 50 N. E. 328 (1898).*

The Circuit Court of Appeals nevertheless invalidated the promise, on the ground that the Kentucky choice of law rule points to New York, and that under New York law the promise is void. As we have demonstrated in

* The law of Delaware, where the Debtor was incorporated and could have been sued in the absence of bankruptcy, likewise upholds the promise. *Central National Bank* vs. *Bateman & Co. Inc.*, 15 Del. Ch. 31, 131 Atl. 202 (1925).

Point I, this reasoning, based as it is on the application of a local choice of law rule in a bankruptcy proceeding, involves a fundamentally faulty approach. But even assuming, for the sake of the argument, that the Circuit Court of Appeals was correct in treating the choice of law problem as if this were a diversity case, the result reached by that court would be incorrect because (1) the Kentucky choice of law rule, if properly ascertained, does not point to New York law, and (2) New York law does not invalidate the instant promise.

(1) The Circuit Court of Appeals, in seeking to ascertain the applicable Kentucky choice of law rule, quoted (R. 221) a dictum of the Court of Appeals of Kentucky to the effect that "it may be stated without exception that, if under the lex loci contractus the contract for any reason is void, it will be invalid everywhere, and will not be enforced by the lex fori, although it would be valid if executed in that jurisdiction." This dictum is quoted from the opinion in *Moody* vs. *Barker*, 188 Ky. 401, 222 S. W. 89 (1920), a case dealing with the capacity of a married woman to subject her property to execution for debts of her husband. The authorities cited in support of this dictum make it clear that the Kentucky Court did not intend to create a particular Kentucky rule, but attempted to follow the "general rules" as stated, for example, in *Wharton's Conflict of Laws*. The same "general rule" prevails in the federal courts* and in the majority of other jurisdictions; but it has not prevented this Court and the overwhelming majority of state courts from adopting a special, and different, rule as to the validity of interest provisions in multi-state contracts. See *Seeman* vs. *Philadelphia Warehouse Co.*, 274 U. S. 403 (1927); 2 *Wharton, Conflict of Laws*, 3rd Ed., pp. 1190-1, 1209-10, and the numerous other authorities cited *supra*, pp. 13-14.

It follows that a statement of the "general" Kentucky choice of law rule concerning the validity of contracts is

* *Scudder* vs. *Union National Bank*, 91 U. S. 406 (1875).

not a sufficient answer to the question presented by the instant case. The Circuit Court of Appeals should have pursued the more specific inquiry whether with respect to the validity of *interest* provisions the Kentucky rule differs from the almost universally accepted *Seeman* rule. This inquiry would have led to the conclusion that where a contract has *bona fide* contacts with several States, the Kentucky courts will uphold its interest provisions if such provisions are valid under the law of one of the States involved. *Commonwealth Farm Loan Co.* vs. *Caudle*, 203 Ky. 761, 263 S. W. 24, 26 (1924); *William Glenny Glass Co.* vs. *Taylor*, 99 Ky. 24, 34 S. W. 711, 712 (1896); *Pensacola & A. R. Co.* vs. *Hilton's Trustee*, 147 Ky. 553, 144 S. W. 1077 (1912). The qualification contained in these decisions, that the actual or presumed intention of the parties will be disregarded if aimed at evasion, is immaterial in the case at bar. As was said by Mr. Justice STONE in *Seeman* vs. *Philadelphia Warehouse Company*, *supra*, at 408:

> "A qualification of these rules, as sometimes stated, is that the parties must act in good faith, and that the form of the transaction must not 'disguise its real character.' [Citation]. As thus stated, the qualification, if taken too literally, would destroy the rules themselves for they obviously are to be invoked only to save the contract from the operation of the usury laws of the one jurisdiction or the other. The effect of the qualification is merely to prevent the evasion or avoidance at will of the usury law otherwise applicable, by the parties' entering into the contract or stipulating for its performance at a place which has no normal relation to the transaction and to whose law they would not otherwise be subject." (274 U. S.)

The First Mortgage Bonds involved herein clearly have a "normal relation" not only to New York, but also to Kentucky and Illinois.* It is therefore a fair inference from the Kentucky cases that a Kentucky court, if faced with the choice of law problem at hand, would have judged the

* See pp. 3, 14, *supra*, and footnote, p. 16, *supra*.

validity of the promise in question by the law of Illinois or Kentucky, and thus would have upheld the promise.

(2) Even if New York law were applicable, the result reached by the Circuit Court of Appeals would not be justified. That Court erred in two respects.

(a) The Circuit Court of Appeals erred in seeking only the New York rule which would be applicable if the bond issue had been a strictly *intra-state* New York transaction. That Court overlooked the fact that we are here dealing with a *multi-state* transaction which has substantial and natural contacts with other States where the promised interest would be lawful. In such a case the New York law is clearly to the effect that the parties must be presumed to have contracted with reference to the law of such State as would uphold the transaction, and that such intent is not to be thwarted by the courts. See *Westchester Mortgage Co.* vs. *Grand Rapids & Ionia Railroad Co.*, 246 N. Y. 194 (1927), where Judge LEHMAN approvingly cited the *Seeman* case. See also *Curtis* vs. *Leavitt*, 15 N. Y. 9, 227 (1857)*, and *Chapman* vs. *Robertson*, 6 Paige 627 (1837), where Chancellor WALWORTH upheld a contract usurious at the place of making and at the place of performance, on the ground that it was good at the place where the security for the debt was located. These New York cases, which embody the New York rule applicable to multi-state transactions, were completely overlooked by the court below.

It is not infrequent that a court of State X, after having determined that a particular transaction is governed by the law of State Y, encounters the difficulty that the law of Y has two different rules and applies one or the other, depending upon whether the transaction is of an intra-state or multi-state character. It stands to reason that where the transaction is clearly a multi-state one, the courts of the forum-State X will follow the rule which the

* That our interpretation of *Curtis* vs. *Leavitt*, which was challenged by the respondents, is the correct one, is borne out by *Miller* vs. *Tiffany*, 1 Wall. 298, 310, footnote (1863).

courts of Y have developed for multi-state transactions. See *Guernsey* vs. *Imperial Bank of Canada*, 188 Fed. 300, 301 (C. C. A. 8th, 1911; unanimous opinion by SANBORN, *J.*, concurred in by VAN DEVANTER, *J.*). Hence, if this litigation had taken place before a state court in Kentucky or Illinois, such court would not have overlooked the *Westchester Mortgage* case and the other above-cited New York cases which make it clear beyond any doubt that at least in a multi-state situation no public policy of the State of New York invalidates a promise to pay simple interest on overdue coupons.

(b) Even the purely intra-state New York cases do not support the view of the Circuit Court of Appeals regarding the New York rule. The same New York cases which are relied on by the Circuit Court of Appeals in the instant case, were analyzed by Judge PATTERSON in *American Brake Shoe & Foundry Co.* vs. *Interborough Rapid Transit Co.*, 26 F. Supp. 954, 955-6 (D. C., S. D. N. Y., 1939). We could not put the matter more clearly and more concisely than it was put by Judge PATTERSON, and for this reason we take the liberty of quoting the following part of his opinion:

> "In New York an agreement at the time of a loan to pay compound interest is void. It is said that such agreements, while not usurious, are 'a temptation to negligence on the part of the creditor and a snare to the debtor, and prove in the end oppressive, and even ruinous.' Young *v.* Hill, 67 N. Y. 162, 168, 23 Am. Rep. 99. 'Interest upon interest, promptly and incessantly accruing, would, as a general rule, become harsh and oppressive. Debt would accumulate with a rapidity beyond all ordinary calculation and endurance. Common business cannot sustain such overwhelming accumulation. It would also tend to inflame the avarice, and harden the heart of the creditor.' Connecticut *v.* Jackson, 1 Johns. Ch. 13, 17, 7 Am. Dec. 471. See also Newburger-Morris Co. *v.* Talcott, 219 N. Y. 505, 114 N. E. 846, 3 A. L. R. 287. Compounding interest is the adding of accumulated inter-

est to the principal at periodic intervals. An agreement to pay simple interest on an overdue installment of interest is different. Computations show it to be far less onerous on the debtor. The distinction was noted in Young *v.* Hill, supra, where the court said (page 174): 'An agreement to pay simple interest upon the several instalments of interest as they became due * * * might not be unreasonable or inequitable'. The same distinction between compound interest and simple interest on overdue interest installments has been recognized elsewhere. Parker *v.* McGinty, 77 Colo. 458, 239 P. 10; Bledsoe *v.* Nixon, 69 N. C. 89, 12 Am. Rep. 642. Vaughan *v.* Kennan, 38 Ark. 114; Morgan *v.* Mortgage Discount Co., 100 Fla. 124, 129 So. 589; note in 27 A. L. R. 81. While general statements may be found in New York cases to the effect that an agreement to pay 'interest on interest' is invalid, the fact is that the agreements under discussion were agreements to pay compound interest. In my opinion the cases dealing with agreements for compound interest do not touch the present case.

"Williamsburgh Savings Bank *v.* Solon, 136 N. Y. 465, 32 N. E. 1058, was relied on at argument as an authority against the allowance of interest on overdue coupons. In that case there was no promise by the borrower to pay interest on overdue coupons. The court merely held that the law would not add such a promise or such a consequence, except where the coupon had been detached and was held by one who did not hold the bond. The distinction dependent on who holds the coupon is a curious one and has not escaped criticism by text writers. But in any event the opinion in the Williamsburgh case does not suggest that a covenant to pay interest on overdue coupons would not be countenanced. The fact that even without a covenant interest is allowed on a dishonored coupon in the hands of a person who does not have the bond must mean that there is no public policy in New York against a covenant of the kind involved here.

"It thus appears that the New York courts have not rendered a decision on the validity of a covenant

by a borrowing corporation to pay simple interest on overdue coupons. The argument for invalidity rests on the cases dealing with agreements for compound interest. But the reasons that led the New York courts long ago to condemn agreements for compound interest have only a remote bearing on agreements for simple interest on overdue coupons. On the other hand there are strong reasons for concluding that a covenant to pay simple interest on overdue coupons is valid in New York. If there were a public policy against the allowance of such interest, the court in the Williamsburgh case would hardly have sanctioned recovery of interest on a coupon held by one who did not hold the bond, where there was not even a covenant to pay such interest. The common appearance of a covenant of this character in contracts for the issuance of corporate bonds and notes indicates its general acceptance by the commercial community. In other states the covenant has uniformly been held valid at common law, even where as in New York agreements in advance for compound interest are not generally recognized. Bowman *v.* Neely, 137 Ill. 443, 27 N. E. 758; Bowman *v.* Neely, 151 Ill. 37, 37 N. E. 840; Parker *v.* McGinty, 77 Colo. 458, 239 P. 10; Central Nat. Bank *v.* Bateman & Companies, 15 Del. Ch. 31, 131 A. 202; Merck *v.* American Land Mortgage Co., 79 Ga. 213, 7 S. E. 265; Murtagh *v.* Thompson, 28 Neb. 358, 44 N. W. 451. It is also significant that by the impressive weight of authority in other jurisdictions overdue coupons are held to draw interest as matter of law, without the assistance of express agreement to that effect by the debtor. 33 Corpus Juris, page 205; Williston on Contracts, section 1417; Daniel on Negotiable Instruments, section 1914. Finally, it is to be borne in mind that in general parties may make what contracts they please. The law enforces the contract as it is written, unless it is contrary to statute or to settled public policy. The burden is on him who asserts invalidity to prove it, and in this case the burden of proving that the covenant to pay interest on overdue coupons is invalid by New York law has not been sustained. The decision is that

the covenant is valid and enforceable under New York law, and that interest at 7 percent should be paid on the outstanding coupons."

Judge PATTERSON's view that under New York law there is a distinction between compound interest and simple interest on an overdue interest claim, was recently adopted by another U. S. District Court sitting in New York. See *In re Realty Associates Securities Corporation*, C. C. H. Bankruptcy Law Service, Third Edition (Current) ¶55690 (D. C., E. D. N. Y., 1946). To the same effect see also *Rich* vs. *The Town of Seneca Falls*, 8 Fed. 852 (C. C. N. D., N. Y., 1881).

The two decisions of Judge CARDOZO which are relied on by the Circuit Court of Appeals (R. 225), are entirely consistent with Judge PATTERSON's reasoning. *Continental Securities Co.* vs. *New York Central & H. Railroad Co.*, 217 N. Y. 119 (1916), involved a plan for the consolidation of certain railroad corporations. The question arose whether under the New York Railroad Law it was permissible to issue, in exchange for existing bonds, new bonds bearing a greater interest rate. Holding that the statute did not prohibit an increase of interest, Judge CARDOZO pointed out that it made no difference that a promise to pay interest was represented by coupons, for "a coupon is merely an incident of the bond without greater force than any other promise for the payment of interest", until detached and separately negotiated. Thus the decision merely reiterates the doctrine of the *Williamsburgh* case, which case, as Judge PATTERSON has made clear, does not deal with the effect of an *express promise* to pay simple interest on interest. In the other decision relied on by the court below, *Newburger-Morris Co.* vs. *Talcott*, 219 N. Y. 505 (1916), Judge CARDOZO interpreted an agreement which provided that interest was to be "charged on the account current * * * at the rate of six percent per annum". The defendant sought to compound interest monthly. The plaintiff objected and was sustained, but there was no discussion by the court, and indeed no dispute by the parties, as to the

validity of an agreement of the kind involved herein, that is, an agreement to pay simple interest on an overdue installment of interest. One of the authorities cited by Judge CARDOZO (*Young* vs. *Hill*, 67 N. Y. at 174), expressly states, as has been pointed out by Judge PATTERSON, that such an agreement "might not be unreasonable or inequitable".

Strong support for the soundness of Judge PATTERSON's analysis of the New York law comes from several decisions of this Court holding that coupons attached to defaulted bonds draw interest from and after maturity under New York law. See *Cairo* vs. *Zane*, 149 U. S. 122, 142 (1893); *Scotland County* vs. *Hill*, 132 U. S. 107, 117 (1889); *Pana* vs. *Bowler*, 107 U. S. 529 (1882). See also N. Y. Civil Practice Act, § 480.

Section 374 of the General Business Law of the State of New York provides that "no corporation shall hereafter interpose the defense of usury in any action". This provision applies to all corporations, whether incorporated in New York or elsewhere. *Southern Life Insurance Co.* vs. *Packer*, 17 N. Y. 51 (1858). While it may be true that respondents' contention as to the invalidity of the interest provision in the case at bar is technically not based on "usury", it cannot be denied that it is based on the allegation of a similar public policy against accumulative interest, and that the difference, if any, between this policy and the policy of the usury laws is verbal rather than real. We submit that the above-quoted statute, if reasonably construed, should prevent a corporate debtor not only from pleading "usury" in the technical sense of the word, but generally from relying upon any public policy invalidating contractual interest provisions. In the *Williamsburg* case this question was not presented, since that case did not involve an express promise to pay interest on overdue interest. In *Young* vs. *Hill*, *supra*, no corporation was involved. The question would seem to be a novel one in New York, so that this Court is free to place a reasonable construction upon the statute. *Meredith* vs. *Winter Haven*, 320 U. S. 228, 237-8 (1943).

Whether one looks to the multi-state or to the intra-state cases in New York, the conclusion is inescapable that the particular promise in issue, which was struck down by the Circuit Court of Appeals as allegedly violating New York law, does not contravene the public policy of New York as declared by the courts of that State, and would have been upheld there. Likewise, if the litigation had been brought in a State court in Illinois or Kentucky, the transaction would have been upheld, since the promise is valid under the law of *each* of the three States involved.

The Circuit Court of Appeals, sitting as a bankruptcy court, thus took it upon itself, purportedly in deference to "local law", to strike down a promise which does not violate the public policy of New York, or of any other State concerned, and which would have been upheld in State court litigation in each of the States with which the transaction has any substantial and natural contact.

Conclusion

It is respectfully submitted that the judgments of the Circuit Court of Appeals, insofar as they reverse the judgment of the District Court, should be reversed with costs, and that the judgment of the District Court should be affirmed with respect to the allowance of interest upon the interest coupons of the First Mortgage Bonds.

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